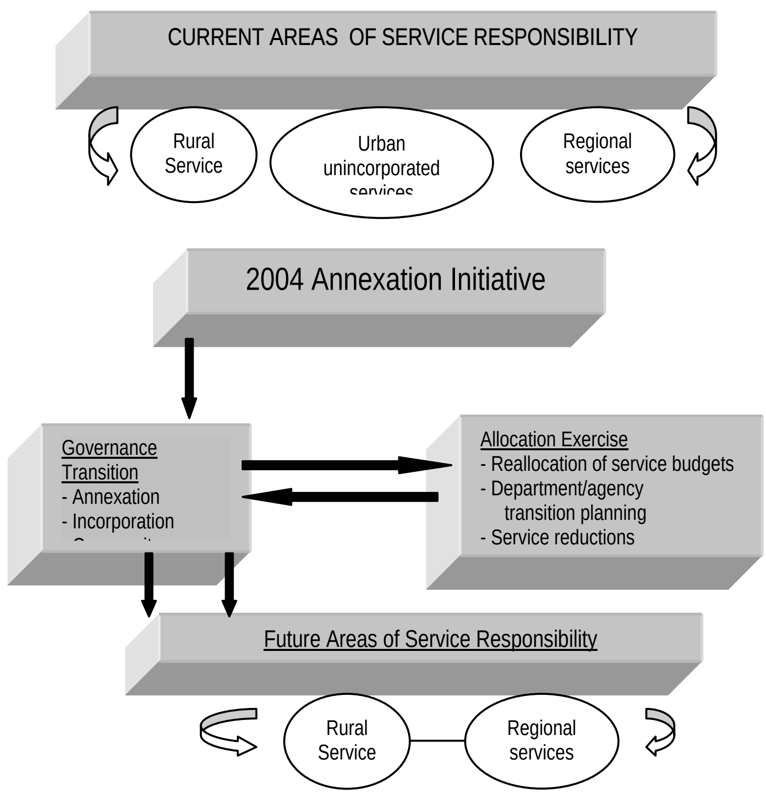
ANNEXATION INITIATIVE AND
2006 PROPOSED REGIONAL/LOCAL
UNINCORPORATED BUDGET ALLOCATION

Introduction and Chapter Overview

The Regional Government Transition chapter replaces the 2005 budget chapter titled '*Annexation Initiative and 2005 Proposed Regional and Local Unincorporated King County Budget.*' It is devoted to a discussion of major actions currently being undertaken by King County to transform itself into a true regional government (see Figure 1 below); one responsible for providing an array of mandated regional services as well as local service delivery to the rural area. Similar to last year, this year's chapter focuses on two major endeavors, one external, and the other internal to county government. They are the annexation initiative, and the regional/local budget allocation task. Through these two endeavors, the county is working toward a transformation that, when accomplished, will contribute to its long term financially stability, enable the citizens of the urban area to receive the expected levels of urban services, and make the regionally adopted land use vision set forth in the Countywide Planning Policies a reality.



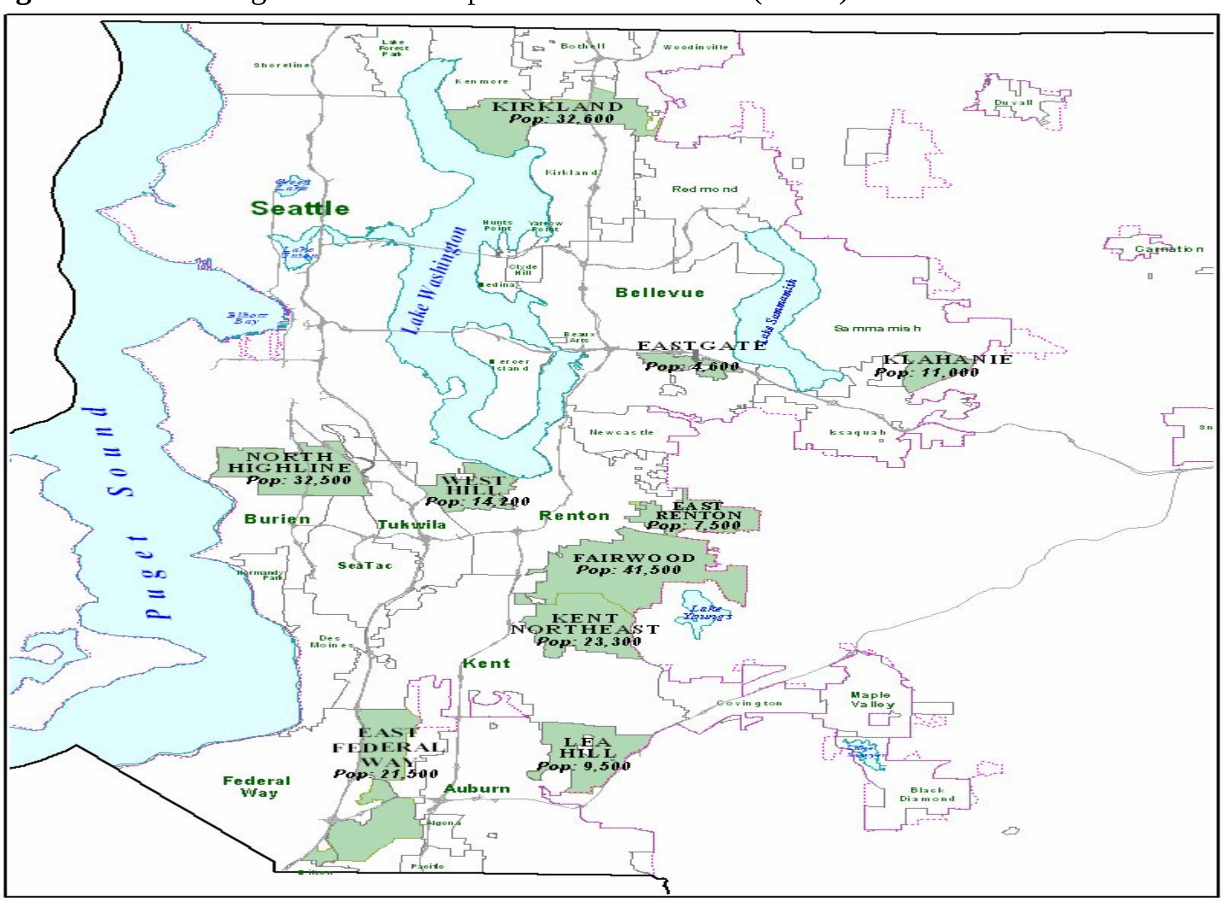
While the annexation initiative and the regional/local budget allocation exercises are to a certain degree interrelated, this chapter is organized in a manner which provides separate in-depth discussions of each. The chapter begins with the Annexation Initiative; including background information, a progress report on past years' activities, and anticipated annexation tasks and activity in 2006. The ensuing discussion focuses on the annual regional/local budget allocation exercise which is an exhaustive interdepartmental exercise, led by the Office of Management and Budget, to review and assess how the county allocates revenue and expenditures by service area responsibility. Through this allocation exercise, the county will be better able to manage its available resources and position itself to make informed decisions regarding the provision of services and allocation of resources.

Annexation Initiative

Achieving Regional Land Use and Service Vision: Nearly ten years after adoption of the county's first Growth Management Act (GMA) comprehensive plan and ratification of the regionally adopted Countywide Planning Policies (CPPs), the county found itself responsible for providing local government services to 218,000 residents living in the communities which comprise the remaining urban unincorporated areas of the county. The CPPs, as required by GMA, call for county government to be the regional and local rural service provider and for cities to be providers of local service in all urban areas — and for this transition to be accomplished by 2012. This bifurcation in service responsibility is important since it preserves the quality of local services to urban communities by transferring governance responsibility for these areas to cities which have greater ability to fund urban local services than does the county.

The continued existence of a large unincorporated population was cause for concern on two accounts: first, the pace of annexation and/or incorporation was not occurring at a rate that would realize the transference of residents to city governance within the CPP 20-year planning horizon; and second, due to its general fund structural budget crisis, the county's ability to continue to provide local services at historic levels was in doubt. Thus it became imperative that the county take some type of action. In response to these concerns, the county, with the adoption of the 2004 budget, launched the Annexation Initiative (AI). The AI is a three year initiative intended to hasten the pace of annexations in an attempt to realize the land use and service vision set forth in GMA and CPP. Correspondingly, attainment of this vision will help alleviate the county's general fund crisis by significantly reducing expenditures on local government services in the urban unincorporated areas as residents migrate to city governance via annexation or incorporation.

Figure 2: Remaining Urban Unincorporated Communities (PAAs)



The AI provides certain funding for city and community led efforts in the 10 largest remaining unincorporated areas, commonly referred as potential annexation areas (PAAs) as shown in Figure 2 above. The allocated funds are to assist cities with transition funding thereby reducing the cost of annexation; and, generate studies and/or community processes in order to provide communities with information upon which they may make an informed decision regarding their governance future.

The remaining PAAs vary in size and character. They range in size from as small as 1.2 square miles to as large as 10.7 miles. The population of some of these PAAs exceeds the populations of many existing cities within King County. Combined, the population of the 10 largest PAAs is equivalent to what would be the second largest city in Washington State. Eight of the 10 PAAs and the rural area have median incomes well in excess of the county's median household income of $53,200. The PAAs represent a mix of well-established neighborhoods built many years ago and newly developed areas with relatively new infrastructure. Both the service needs and infrastructure requirements vary among these areas.

Table 1
PAA General Information

Area	Annexing City	Area in Square Miles	Population – Estimated 2004 Population	Median Household Income – 2000 Census
East Federal Way	Federal Way	7.9	21,500	$62,400
East Renton	Renton	3.3	7,500	$65,300
Eastgate	Bellevue	1.2	4,600	$65,600
Fairwood	Renton	10.7	41,500	$58,000
Kent Northeast	Kent	5.5	23,300	$65,700
Finn Hill-Juanita-Kingsgate	Kirkland	6.9	32,600	$69,800
Klahanie	Issaquah	1.9	11,000	$84,700
Lea Hill	Auburn	4.3	8,500	$65,700
North Highline	None	6.2	32,500	$39,950
West Hill	None	3.2	14,200	$47,385
"Other" urban areas			20,600	

Greater Fiscal Stability and Annexation: As shown in Table 2 below, the PAAs currently do not generate sufficient local revenues to cover the cost of providing local services through the county's Current Expense (CX) fund. Urban unincorporated expenditures in 2006 are estimated at nearly $42.5 million with supporting revenues at $22.6 million resulting in $19.9 million gap. In order to close the gap between urban unincorporated revenues and expenditures, often referred to as the "urban subsidy", the county must expend a corresponding amount of its regional revenues to maintain basic urban unincorporated services. The expenditure of regional revenues on urban unincorporated services comes at the direct expense of mandated regional and rural services. Thus, annexation, if followed by corresponding local service budget reductions, will provide significant budget relief for regional and rural services supported through the CX Fund.

Table 2
General Fund (CX) Summary 2006 Local Services Budget*
(in millions)

General Fund	Total Unincorporated King County	Total Urban Local	Total Rural Local
Revenues	$35.9	$22.6	$13.3
Expenditures	$73.2	$42.5	$30.7
Ending Fund Balance	($37.3)	($19.9)	($17.4)

Annexation Initiative - Progress to Date

Year One – Implementation: With the commencement of the AI, the Executive engaged the region and impacted cities and communities individually as to the importance of accelerating the pace of annexations and incorporations. New interest by cities in considering annexation of the West Hill and Highline/Boulevard Park/White Center areas were notable steps forward. In addition, King County's legislative work in Olympia raised the visibility of the annexation as an issue which increased the understanding of the obstacles to annexations and resulted in funding for a state study on annexation challenges. This study, completed in December 2004 by the state Department of Community, Trade and Economic Development, provides a solid basis for state-level dialog.

In July of 2004, the Executive transmitted a detailed report on the Annexation Initiative to the Metropolitan King County Council setting forth an overview of King County's budget crisis and how the Initiative responds to that crisis; the status and challenge of implementing the region's land use vision; a fiscal analysis of costs and revenues associated with the major urban unincorporated areas; the proposed policy framework regarding the vision, goals, allocation of funding, and negotiating principles for the Initiative; and the implementation plan for the Initiative, including the management plan, organizational structure, and Year 2004, 2005, 2006 work plan objectives and tasks.

In response to this report, the County Council adopted Motion No. 12018 on September 27, 2004 approving the vision, goals and policies to guide the Initiative, as well as the 2005 work plan. The Motion directs that the allocation of annexation incentive funds reflect achievable savings to the General Fund facilitated by that annexation or incorporation. Fulfilling this requirement requires significant effort to identify the specific financial and operational consequences for each county department providing local urban services that will occur upon annexation or incorporation of any or all of the remaining unincorporated urban areas.

Year Two – Dialog with Cities and Residents and Transition Planning: The second year of the Annexation Initiative can best be described as the year of planning. The following county funded governance studies and/or community processes and analysis were undertaken or completed: West Hill Governance Options Assessment; North Highline Incorporation Feasibility Study; Kirkland Level of Service Analysis; East Renton citizen advisory group and community meetings; and, Fairwood Incorporation Feasibility Analysis. In addition to these county studies and community-based efforts, the Cities of Kirkland, Renton, Seattle, Kent, Burien, and Issaquah undertook their own efforts to assess the cost of annexing their respective potential annexation areas (PAAs). All of these planning efforts will help lay the groundwork for earnest discussions and future governance change.

The second year of the AI also saw the completion of the first annexation interlocal agreement under the AI and Council Motion. Provided a successful annexation vote occurs in November 2005, the City of Issaquah will annex the Klahanie and Greenwood/South Cove communities effective March 2, 2006. The interlocal agreement[1] that was ratified during the summer by both legislative bodies sets forth: a transfer of incentive funds calculated based on potential savings to the CX fund as stipulated by Council Motion, a transfer of programmed road capital funds for the Issaquah-Fall City road project, the conditions and mechanisms for ensuring a seamless transfer of local services (permitting, police, surface water management, etc.) to city responsibility, and the transfer of park and surface water facilities to the city. Completion of the annexation interlocal agreement with the City of Issaquah affirms that the AI is an effective means to hasten the pace of annexation and of interest to the suburban cities.

Year Three – Change in Governance: Based on the significant amount of planning work undertaken in year two, 2006 should be a year in which a number of annexations and an incorporation decision occur. The Executive will continue to focus its efforts in the three designated priority areas (North Highline, Kirkland, and Fairwood) as well as other communities such as West Hill and East Renton Plateau that may seek an annexation vote. In addition, the Executive will continue to work with various county and city associations, state and local elected leaders, and others to pursue changes to state statute that would serve to streamline the various annexation methods; provide new funding sources to either ease the cost of annexation; or to provide the county with funds to provide local services until such time as annexation occurs.

Internally, much effort will be put into transition planning. The county will continue to develop plans to offer competitive contract services to cities following annexation or incorporation. Consistent with county policy, these plans must incorporate full-cost recovery for the county. Transition planning must also thoroughly examine the impact of decreased levels of direct service provision on departmental overhead, countywide overhead, and internal service fund expenditures. The challenge will be to identify maximum practicable savings in overhead as direct service expenditures are reduced. Securing overhead savings is critical not only in terms of competing to provide new contract services, but also to remaining competitive in the delivery of *existing* contract services.

A discussion regarding rural service delivery will be initiated. As the number of PAAs decrease over time, the county will need to focus its attention on defining a new service delivery model for the rural area of King County. County facilities and service districts were located or drawn to provide services to both the rural and urban unincorporated area.

Continued Commitment to Urban Unincorporated Communities: Despite over $137 million in budget cuts in the past five years, the county will continue to provide local urban services and to make capital investments identified in the various departments' capital improvement programs, commensurate with available revenues. As opportunities arise, the county may elect

[1] Please see Allocation section for an expanded discussion regarding the Klahanie agreement and potential savings.

to make strategic investments in communities where it would be a clear benefit, such as increased economic activity or serve to preserve vital infrastructure.

Success Measured Over Time: The transition of urban unincorporated areas to city status will not be accomplished in a single year and the success of the AI is dependent upon a variety of factors. Foremost is the support of cities and the residents of urban unincorporated areas, as it is they who unilaterally control the decision to annex or incorporate. The county is relegated, due to state statute, to a role of promoting and encouraging these transitions. Equally important is the county's ability to hold itself accountable for reductions in local urban service budgets as annexations occur or, alternatively, to provide new contract services at full cost recovery in these areas. Another important factor is the county's ability to adequately address internal charges, such as overhead. While the challenges are multiple and complex, the Executive will continue to make implementation of the Annexation Initiative a priority in 2006, given both the significant financial benefits potentially generated to the county's CX Fund, and the substantial progress in meeting the goals of the State Growth Management Act and the CPPs.

2006 Regional and Local Budget Allocation

Background: The regional and local budget allocation exercise is an important internal accounting of how the county allocates and tracks regional, rural and urban unincorporated expenditures and revenues. The annual allocation exercise provides a budgetary basis upon which to plan for or respond to change whether that change is attributable to annexation activity, council priorities, or some other event such as voter initiative. In order to be an efficient and effective government, the county needs to have adequate allocation information to plan for and affect changes to its local service models, including changes that may impact the location of facilities, programs, service districts, or the amount of CX transfer to agencies such as the Department of Development and Environmental Services (DDES) and Parks. With the advent of the AI, this exercise has taken on additional importance as department and agency revenues and expenditures must also be tracked by PAA in order to realize savings associated with annexation or incorporation activity. Similarly, the exercise will provide baseline date for looking at changes in regional and rural service levels over time.

Regional, Contract, and Local Expenditures and Revenues by Key Fund: Beginning in 2003, the Executive Proposed Budgets have provided an allocation of revenues and expenditures by area of service responsibility – urban local, regional, and rural. In each subsequent year, the methodology and quality of the data have been refined and improved upon, allowing for greater accuracy in deriving revenue and expenditure figures. In 2005 there was continued effort to improve the allocation model for law, justice and public safety costs based on work load indicators by geographical area. Both the District Court and the Sheriff proposed significant changes to the allocation methodology based on improved work load information generated in their operational master plan processes. Like last year, the analysis was extended to examine revenues and expenditures by the ten major urban unincorporated areas. As part of the 2006 budget development process, all county departments were asked to review the allocation methodology and propose changes that would improve its accuracy. The Sheriff's Office, District Court, and Department of Community and Human Services all proposed changes at the regional, contract, local, and PAA level to better align the allocation with workload and associated expenditures. The DDES and the Parks division also refined their allocation of CX transfer to reflect urban unincorporated area workload. The base year data for the revenue allocation model was updated to reflect 2004 actuals.

Tables 3 and 4 below provide an allocation of revenues and expenditures for both CX and non-CX funds respectively. While much attention has been paid to the CX fund due to its structural imbalance, an understanding of how non-CX funds are allocated is important as these funds are immediately impacted by revenue loss attributable to the removal of tax or service fee base through annexation or incorporation.

Table 3 shows the county's CX fund is the only fund with a deficit for urban unincorporated and rural service budgets. Based on 2006 calculations, the total local service imbalance is estimated at $37.3 million; $19.9 million for urban unincorporated services, and $17.4 million for local rural services. This resulted in a total decrease of the annual deficit for the PAAs of approximately $2.3 million from the 2005 calculations. Refinement of geographic-based workload estimates, particularly in law, safety and justice agencies and CX fund transfers for DDES and Parks, as opposed to population based proxies were the main cause of this adjustment. In addition, health and human service agencies are transitioning to regionally based services. These calculations also modified the Children and Family Set Aside (CFSA) transfer to align with CFSA revenues. Geographic-based revenue estimates were used to determine revenue allocation. As noted above, the revenue shortfall is made to "balance" with the reallocation of *regional revenues* to the unincorporated area, thus reducing the amount of money available for mandated regional services. Table 3 also depicts the magnitude of the county's current contract service obligations. These contracts constitute a significant portion of the local urban service work currently performed by various county departments in cities.

Table 3
2006 Regional, Contract, and Local Budget Allocation -- CX Fund
(In millions)

General Fund	General Fund Total	Regional Services	Contract and Grant Services	Total Unincorporated King County	Urban Local Services	Rural Local Services
Beginning Fund Balance	$107.4	$107.4				
Revenues	$575.20	$447.30	$92.0	$35.9	$22.6	$13.3
Expenditures	$576.0	$414.3	$88.5	$73.2	$42.5	$30.7
Ongoing annual surplus/(deficit) and no reserves	$106.60	$140.40	$3.5	($37.3)	($19.9)	($17.4)

Table 4 below shows the non-CX funds allocation by local service function. At the total fund level, the non-CX funds are required by law or county policy to balance. However, at the PAA allocation level, revenues and expenditures may not balance as they vary year to year.

Table 4
2006 Non-CX Regional, Contact, and Local Budget Allocation
(In millions)

		2006 Proposed Budget	Regional	Contract & Grants	Total Unincorporated King County	Urban Unincorporated King County	Rural King County
SURFACE WATER MANAGEMENT AND RURAL DRAINAGE							
	Beginning Fund Balance	$0.5					
	Revenues	$48.5	$26.5	$8.8	$13.1	$5.9	$7.2
	Expenditures	$48.7	$21.0	$2.0	$25.7	$11.4	$14.3
	Ending Fund Balance	$0.3	$5.5	$6.8	($12.5)	($5.4)	($7.1)
	Other Fund Transactions	$0.5					
	Ending Undesignated Fund Balance	$0.7					
DEVELOPMENT AND ENVIRONMENTAL SERVICES FUND							
	Beginning Fund Balance	$7.5					
	Revenues	$30.0	$0.0	$0.0	$30.0	$15.7	$14.3
	Expenditures	$31.1	$0.0	$0.1	$31.0	$16.2	$14.8
	Surplus/(deficit)	($1.1)	$0.0	($0.1)	($0.9)	($0.5)	($0.5)
	Reserves	$3.6					
	Ending Undesignated Fund Balance	$2.8					
PARKS AND RECREATION							
	Beginning Fund Balance	$1.8					
	Revenues	$23.1	$17.0	$0.0	$3.6	$2.7	$0.9
	Expenditures	$20.8	$15.6	$0.0	$5.2	$2.9	$2.3
	Surplus/(deficit)	$2.3	$1.4	$0.0	($1.6)	($0.2)	($1.4)
	Other Fund Transactions	$0.4					
	Ending Undesignated Fund Balance	$4.4					
REET 1 and 2							
	Beginning Fund Balance	$14.6					
	Revenues	$17.7	$4.3	$0.0	$13.4	$7.6	$5.8
	Expenditures	$22.3	$17.7	$0.0	$4.5	$0.5	$4.0
	Surplus/(deficit)	($4.5)	($13.4)	$0.0	$8.9	$7.1	$1.8
	Reserves	$9.0					
	Ending Fund Balance	$1.0					
COUNTY ROAD FUND							
	Beginning Fund Balance	$0.9					
	Revenues	$115.7	$1.2	$13.9	$100.6	$49.1	$51.5
	Expenditures	$115.7	$2.0	$13.8	$99.8	$52.6	$47.3
	OFT's	$0.1					
	Underexpenditure Assumptions	$0.7					
	Ending Fund Balance	$1.5	($0.7)	$0.0	$0.8	($3.4)	$4.2

* Totals may not add due to rounding.

Financial Analysis by Major Potential Annexation Area: Extending the allocation analysis to individual urban unincorporated areas was a major step forward in the 2005 proposed budget. The effort to refine this analysis will continue in 2006. Refinement of geographic-based workload estimates -- particularly for law, safety and justice agencies -- as opposed to population-based "proxies" for costs, has improved the allocation's accuracy. Tables 5 and 6 depict revenues and expenditures for CX and non-CX funds.

Table 5
2006 General Fund (CX) Local Service Revenues and Expenditures by Major Urban Potential Annexation Area
(Includes Criminal Justice sales tax revenues)
(In millions)

General Fund	Klahanie (with annexation)	Finn Hill-Juanita-Kingsgate	Renton E	West Hill	North Highline	Eastgate	Kent NE	Lea Hill (2007)	East Federal Way	Fairwood	Other Urban Islands	Total
Revenues	$0.1	$3.2	$0.6	$2.4	$4.4	$0.4	$2.2	$0.8	$1.7	$4.8	$2.0	$22.6
Expenditures												
Capital Improvement Program	$0.1	$0.2	$0.0	$0.1	$0.2	$0.0	$0.1	$0.1	$0.1	$0.2	$0.1	$1.2
General Government	$0.1	$0.4	$0.1	$0.2	$0.4	$0.1	$0.3	$0.1	$0.3	$0.6	$0.3	$2.9
Health & Human Services	$0.0	$0.1	$0.0	$0.0	$0.1	$0.0	$0.0	$0.0	$0.0	$0.1	$0.0	$0.5
Law, Safety, & Justice (excluding Sheriff)	$0.1	$0.6	$0.1	$0.7	$1.8	$0.1	$0.3	$0.2	$0.5	$0.9	$0.4	$5.6
Sheriff	$0.2	$3.0	$0.6	$3.4	$7.9	$0.3	$1.6	$1.2	$2.4	$4.4	$2.2	$27.1
Other Agencies	$0.0	$0.1	$0.0	$0.1	$0.1	$0.0	$0.1	$0.0	$0.1	$0.2	$0.1	$0.9
Parks/DDES	$0.2	$0.4	$0.1	$0.2	$1.5	$0.0	$0.3	$0.1	$0.7	$0.9	$0.2	$4.5
Underexpenditures	($0.0)	($0.0)	($0.0)	($0.0)	($0.0)	($0.0)	($0.0)	($0.0)	($0.0)	($0.1)	($0.0)	($0.3)
Total Expenditures	$0.6	$4.8	$1.0	$4.7	$12.0	$0.6	$2.7	$1.7	$4.1	$7.2	$3.1	$42.5
Surplus/(deficit)	($0.5)	($1.6)	($0.4)	($2.3)	($7.6)	($0.2)	($0.5)	($0.9)	($2.4)	($2.4)	($1.1)	($19.9)

Based on 2005 efforts with cities and communities, the areas of North Highline, West Hill, East. Renton, Klahanie and Fairwood-Petrovitsky are actively engaged in discussions and direct efforts to become part of an adjoining city or incorporation. As depicted in Table 5, these areas account for nearly $25.5 million, or 60% of the county's expenditures for local services in the Current Expense fund. They also represent 54 percent of the population (106,700) of the ten major PAAs. Successful annexation or incorporation for these areas alone would present marked progress under the AI and result in substantial opportunities for creating savings within the Current Expense Fund. However, it is important to note that estimated costs are unlikely to equal actual savings as these costs figures include fixed and indirect costs that will not necessarily decline with changes in local service provision.

Table 6
Local Service Budgets for Non-CX funds by PAA
(In millions)

Non CX Funds	Klahanie (with annexation)	Finn Hill-Juanita-Kingsgate	Renton E	West Hill	North Highline	Eastgate	Kent NE	Lea Hill (2007)	East Federal Way	Fairwood	Other Urban Islands	Total
SURFACE WATER MANAGEMENT AND RURAL DRAINAGE												
Revenues	$0.0	$1.2	$0.3	$0.5	$0.8	$0.2	$0.6	$0.2	$0.3	$1.3	$0.6	$6.0
Expenditures	$0.0	$1.9	$0.4	$0.7	$1.7	$0.2	$1.3	$0.7	$1.1	$2.1	$1.3	$11.4
Surplus/(deficit)	($0.0)	($0.7)	($0.1)	($0.2)	($0.9)	$0.0	($0.7)	($0.5)	($0.7)	($0.7)	($0.8)	($5.3)
DEVELOPMENT AND ENVIRONMENTAL SERVICES FUND												
Revenues	$0.0	$2.5	$0.6	$1.1	$2.5	$0.4	$1.8	$0.7	$1.5	$3.2	$1.5	$15.8
Expenditures	$0.0	$2.6	$0.6	$1.1	$2.5	$0.4	$1.8	$0.8	$1.6	$3.3	$1.5	$16.2
Surplus/(deficit)	$0.0	($0.1)	$0.0	$0.0	($0.1)	$0.0	($0.1)	$0.0	$0.0	($0.1)	$0.0	($0.4)
PARKS & RECREATION												
Revenues	$0.0	$0.2	$0.0	$0.2	$1.3	$0.0	$0.1	$0.0	$0.8	$0.1	$0.0	$2.7
Expenditures	$0.0	$0.2	$0.0	$0.2	$1.4	$0.0	$0.1	$0.0	$0.8	$0.1	$0.0	$2.9
Surplus/(deficit)	$0.0	$0.0	$0.0	$0.0	($0.1)	$0.0	$0.0	$0.0	($0.1)	$0.0	$0.0	($0.2)
COUNTY ROAD FUND												
Revenues	$0.0	$8.2	$1.9	$3.0	$5.0	$1.2	$4.0	$2.0	$3.3	$9.0	$11.3	$49.1
Expenditures	$0.0	$1.7	$1.7	$3.4	$3.9	$0.7	$2.7	$1.8	$3.4	$8.7	$24.5	$52.6
Surplus/(deficit)	$0.0	$6.5	$0.3	($0.4)	$1.1	$0.5	$1.3	$0.2	($0.1)	$0.3	($13.2)	($3.4)
REET 1 & 2												
Revenues	$0.07	$2.0	$0.2	$0.4	$0.7	$0.2	$0.6	$0.4	$0.3	$1.6	$1.2	$8.0
Expenditures	$0.0	$0.0	$0.0	$0.0	$0.2	$0.0	$0.0	$0.0	$0.2	$0.1	$0.0	$0.5
Surplus/(deficit)	$0.07	$1.9	$0.2	$0.4	$0.5	$0.2	$0.6	$0.4	$0.1	$1.5	$1.2	$7.0

Table 6 provides the detailed analysis of proposed 2006 revenues and expenditures for the ten major urban unincorporated areas for the six highlighted funds.

Comparison of Allocated Costs versus Savings -- The Klahanie PAA: Budget allocations at the PAA level allow for further analysis to determine the impact on both revenues and expenditures brought about by annexation of a given PAA. The Klahanie annexation provides an example of how “savings” from this annexation will be of benefit to the CX fund. Motion 12018 directs the Executive to provide specific timelines and budget reductions associated with the county not providing local services to annexed or incorporated areas slated to receive Annexation Incentive funds. The Executive provided budget impact estimates associated with the annexation of the Klahanie area as part of the transmittal of Proposed Ordinance 2005-0269 that authorized the Executive to enter into an interlocal agreement with the City of Issaquah to provide for the smooth transition of services, transfer of properties, and provision of incentive funds upon the effective date of annexation. As part of the 2006 budget, departments providing direct local services in Klahanie refined their budget reductions resulting from the loss of work load associated with the annexation. The following tables detail the changes included in departments' budgets due to decreased workload assuming approval of annexation by the voters in November 2005.

Table 7
Summary of Program Changes Resulting from Klahanie Annexation
For CX Local Services

	OMB Reductions Estimate— Spring 2006 (high target)	**Department Reductions Estimate— Spring 2006**	***2006 Executive Proposed Budget***
LOCAL REVENUES (for January and February 2006)	$106,000	$106,000	*$130,000*
EXPENDITURES			
Adult Detention	($35,739)	($5,000)	*($4,884)*
Jail Health Services	($3,029)	($4,000)	*($4,000)*
Prosecuting Attorney	($16,377)	$0	*$0*
Public Defense	($13,768)	($1,000)	*($1,000)*
Sheriff	($270,297)	($200,000)	*($287,000)*
District Court	($29,456)	0	
CFS Transfers to HOF	($21,756)	0	*0*
CSFA Transfers – Community Services Division	($13,668)	0	*0*
Human Service Fund Transfer	($49,556)	0	*0*
Parks Fund Transfer	($59,234)	($42,000)	*($43,000)*
DDES Transfer	($60,441)	0	*0*
Community, Parks, DDES and Human Service Transfers	($204,655)	($42,000)	*$(43,000)*
Subtotal Direct Local Services	($573,322)	($252,000)	*($339,224)*
Subtotal General Government/Indirect Local Services	($48,765)	0	*0*
Total Reductions	**($622,087)**	**($252,000)**	***($339,224)***

In terms of the General Fund, assuming voter support for annexation in November, the Executive's Proposed Budget changes attributable to Klahanie total nearly $340,000 in budget decreases. With regard to the Sheriff, the savings estimated at $287,000 are proposed to be reinvested for improved police service in the adjacent rural area, consistent with the intent of redirecting General Fund resources to the provision of regional and rural services. Approximately $53,000 is generated from a reduced CX transfer to Parks and reductions in DAJD and Jail Health Services and represents a savings benefit to the General Fund. The General Fund budget savings attributable to the pending Klahanie annexation are consistent with the range of savings presented to the King County Council during their consideration of the Interlocal Agreement with the City of Issaquah.

Local service revenues for the Roads Fund, Water and Land Resources Funds, Real Estate Excise Tax Funds, and Department of Development and Environmental Services as shown in Table 8 below, will all be reduced, should voters approve the annexation. Accordingly, these local service departments have proposed budget reductions for direct local services previously provided in the Klahanie area. As the table indicates, in instances where the direct service costs are less than the total revenue loss, these agencies had to absorb the remainder program wide.

Table 8
Summary Other Funds Budget Changes from Klahanie Annexation

	2006 Revenue Loss	Direct Expenditures. Savings	Remainder to be reduced program wide
Road Services Division	$2,323,951	($372,683)	($1,951,268)
Water and Land Resources/Surface water Management	$436,744	($275,106)	($161,638)
REET 1 and 2	$605,656	$0	($605,656)
DDES fees	$69,407	($69,407)	$0

Projecting Future Savings to the King County General Fund from Accelerated Annexation and Incorporation:

As noted at the beginning of this chapter, there are two primary objectives of the Annexation Initiative. The first is the policy goal to actively implement the public service vision for counties established in the State's Growth Management Act as regional and rural service providers and to let cities provide local services in urban areas. The second objective is to generate fiscal benefits by ending the General Fund's regional subsidy of urban local services in unincorporated King County. The 2006 regional subsidy for the remaining urban unincorporated areas (excluding Klahanie) has been estimated at $19.4 million for 2006. To generate a net fiscal benefit from urban annexations, the county must be able to reduce expenditures by more than the amount of revenue lost when areas transition to incorporated status. The remaining nine major urban PAAs generate approximately $20.5 million in local revenues that will be forgone by the county upon annexation as opposed to $38.8 million in allocated local service costs. To be financially neutral, the county will need to cut more than $20.5 million in local expenditures, or approximately 53 percent of the total allocated local service expenditures. Budget reductions over and above 53 percent *in aggregate* will have to be targeted to generate fiscal benefit for the General Fund. Recognizing that local service costs have both direct and indirect cost components (overhead, administrative, and general government costs), reductions will be made across all categories to achieve the financial savings necessary to promote greater fiscal stability in the long run. Achieving this level of savings presents a high bar and will require fiscal discipline. Motion 12018 directed the executive to provide specific estimates of savings by department for each proposed annexation interlocal agreement. In response to that requirement, development of an improved method for estimating savings was a key work element in 2005.

The ease of reducing county expenditures varies by PAA. For areas such as North Highline and West Hill/Skyway that are relatively defined and stand alone from other unincorporated areas, it is easier to clearly identify dedicated expenditures that can be reduced upon annexation. However, due to the budget cuts King County has already implemented, many direct service departments have tried to increase efficiency by sharing local service resources over larger areas that cross PAA and rural area boundaries making it more difficult to easily reduce operating expenses and staffing levels when urban areas transfer. In urban PAAs that abut the rural area, King County direct local services departments will likely have to reorganize how they provide service to the remaining unincorporated areas in order to find savings. It is not as simple as reducing expenditures and FTEs, as the same resources may be also serving an area that is still unincorporated. The challenge is increased given the lack of certainty as to timing of the effective date of annexations. Consequently, many direct service departments such as the Sheriff are developing long term operational plans that examine different annexation scenarios and how to best reorganize resources for greatest effectiveness and efficiency given different annexation alternatives.

Given the complexity of projecting accurate savings given the uncertain timing of annexations as well as the likely need for reorganization efforts by departments and the Council motion directive, refining the model was a work program task for 2005. Early estimates of the financial gain assumed that savings reductions could be as high as eighty percent of allocated costs less forgone revenues. When the remaining major PAAs are taken as a whole based on the 2006 allocation, such an approach yielded savings potentials of $11 million annually if all areas were annexed at once. Because annexations will not happen this way, the method does not accurately forecast realistic savings estimates. This approach assumes the same savings levels across all service areas across all PAAs. The approach does not reflect that the annexations would likely be phased and that the level of savings may change over time as FTE reductions were accumulated by workload reductions.

In developing the financial analysis for the Klahanie Annexation proposal, the Office of Management and Budget developed an alternative savings target methodology that phased in savings to account for departments having to reorient their service models to achieve savings in both direct and indirect costs. The savings target percentages are different for the various functional areas to address the variation in operational models and cost structures. The methodology also provides high and low savings scenarios to present benchmarks for assessing the potential payback periods for incentive payments made to cities upon annexation. Instead of modeling savings for all PAA in aggregate, each PAA is being evaluated individually reflecting the likely timing of annexation and the revenue and service cost characteristics of the area.

Based on the work to date with various cities and unincorporated citizens groups, the Office of Management and Budget is modeling the impacts of annexation in accordance with the following working timelines for potential annexations and incorporations:
Potential Annexation Area and Effective Date

- Klahanie -- March 2006
- East Renton -- January 2007
- North Highline -- July 2007
- Fairwood Incorporation -- July 2007
- West Hill/Sky Way -- January 2008

Given uncertainty of the timing of the remaining six areas (Eastgate, Finn Hill-Juanita-Kingsgate, Federal Way PAA, Lea Hill, Cascade Vista ((area outside of the proposed Fairwood incorporation)) and Kent), savings were not projected for these areas. However, given the subsidy levels in Federal Way and Kirkland PAAs, there may be notable fiscal benefits from savings in those areas as well.

Based on this anticipated timeline, high and low savings target scenarios were modeled for a five year period. The following table presents the project net impacts annually.

Table 9
Projected General Fund Savings Based on Phased Reductions – Lower Savings Rate Scenario

PAA – Projected Date	2006	2007	2008	2009	2010
Klahanie -- 3/2/06	($456,253)	($568,083)	($431,447)	($327,632)	($215,247)
East Renton --1/1/07	$0	($376,716)	($389,280)	($138,827)	($138,986)
North Highline --7/1/07	$0	$1,452,697	$3,751,664	$4,984,535	$5,368,633
Fairwood Incorporation - 7/1/07	$0	($442,125)	($898,627)	($454,661)	($445,125)
West Hill 1/1/08	$0	$0	$707,171	$768,208	$1,132,309
TOTAL net impact	**($456,253)**	**$65,773**	**$2,739,481**	**$4,831,622**	**$5,701,584**

Table 10
Projected General Fund Savings Based on Phased Reductions – Higher Savings Rate Scenario

PAA -- Projected Date	2006	2007	2008	2009	2010
Klahanie -- 3/2/06	($153,690)	($186,855)	($70,561)	($65,702)	$69,358
East Renton --1/1/07	$0	($279,812)	($287,531)	($1,819)	$4,873
North Highline --7/1/07	$0	$2,807,266	$6,338,576	$7,657,118	$8,089,397
Fairwood Incorporation - 7/1/07	$0	$23,434	$127,550	$383,144	$434,570

West Hill 1/1/08	$0	$0	$1,760,952	$1,874,678	$2,308,709
TOTAL net impact	**($153,690)**	**$2,364,034**	**$7,868,985**	**$9,847,419**	**$10,906,907**

The results from the revised savings methodology indicate that in both the low and high savings target scenarios significant savings could be achieved upon the annexation of North Highline and West Hill. By 2008, the first point where a full year of savings is modeled, these total savings figures range from nearly $2.7 million in the lower savings target scenario to $7.8 million in the higher savings target scenario in nominal dollars annually, with the majority being attributable to these two urban areas. Due to the lower subsidy attributed to the proposed Fairwood incorporation area, positive fiscal impacts are projected only in the higher target savings scenario Net fiscal gains for King County from the Fairwood incorporation could be larger from increased contract reviews which are not included in this analysis. Given the relatively small size of Klahanie and East Renton in terms of local service workload and proximity to the rural area, savings are not projected in the short term. In total, the revised savings projections demonstrate there is a considerable financial benefit from continuing to work towards accelerated annexations.

Attaining a significant level of Current Expense savings will require difficult budget choices and long term fiscal discipline. At the same time, several non-CX funds such as the County Road Fund, Surface Water Management Fund, Real Estate Excise Tax Funds, and the Department of Development and Environmental Services will likely experience significant changes in their underlying revenue streams as a result of annexations and incorporations if contract services are not maintained and further expanded in response to the loss of direct service responsibilities. While net benefits are achievable in the CX fund, these gains must be accomplished in a manner that upholds prudent operational and financial planning for the county programs with continued service obligations in the rural area. Preserving the financial viability for the county's remaining rural service responsibilities will be a concurrent objective to identifying cost savings for the General Fund as transition plans are developed in 2006.

Successful implementation of the Annexation Initiative continues to be challenging and time consuming. The transfer of these areas to city status will occur over multiple years complicating efficient delivery of services to remaining areas. The fiscal implications for department and county overhead and internal service funds will result in overall savings as workload is decreased, but can also result in cost increases as fixed costs are spread over fewer agencies. Despite the challenge, the options for addressing the structural budget gap are limited and this work must be pursued because if successful, the savings over time to the CX Fund may be dramatic.

2006 Funding: The Executive is proposing that the funding levels approved in the 2005 Adopted Budget for the Annexation Initiative incentive funds be maintained in the 2006 Budget. Progress is being made under the AI and therefore it is in the best interest of the county to maintain the momentum with the suburban cities and unincorporated residents. As presented in the estimated savings analysis, significant fiscal benefit may be realized with annexations of West Hill and North Highline in particular. King County's ability to provide financial incentives is crucial to the county's ability to promote accelerated annexations to cities. The provision of financial incentives as a one time investment on the county's part but has the potential to yield substantial financial benefits for the General Fund if targeted correctly.